Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matters of	
Access Charge Reform	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1
Interexchange Carrier Purchases of Switched Access Services by Competitive Local Exchange Carriers	CCB/CPD File No. 98-63
Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	CC Docket No. 98-157

BELL ATLANTIC REPLY IN SUPPORT OF ITS PETITION FOR RECONSIDERATION

In its reconsideration petition, Bell Atlantic[1] demonstrated why it is both unreasonable and unconstitutional for the Commission to condition the granting of minimal pricing flexibility for certain services on a LEC's giving up the low-end adjustment protection for all of its interstate services. Commenters opposing the petition have made arguments that are both incorrect and misleading. In particular, AT&T is wrong to argue that it is sufficient for constitutional purposes for a price-cap system to permit confiscatory rates for regulated services

[1] These reply comments are filed on behalf of the Bell Atlantic telephone companies: Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company (collectively "Bell Atlantic").

so long as the company is able to avoid insolvency by relying on revenues from competitive services. Other commenters err when they argue that the risk that rates might actually fall to confiscatory levels is too speculative to warrant the Commission's concern. Because recent Commission proposals could have the effect of reducing LEC rates below confiscatory levels, the low-end adjustment protection is more important than ever.

Since establishing the price-cap scheme, the Commission has consistently justified the low-end adjustment mechanism as necessary to ensure that the price-cap formula does not force a particular local exchange carrier's rates down to confiscatory levels and thereby exact an unconstitutional taking. In the *Fifth Report and Order*, the Commission abandoned its commitment to this constitutionally required protection. Instead of modifying the low-end adjustment mechanism to reflect changes in the way certain services will be regulated under price caps, the Commission required price-cap local exchange carriers to choose between limited pricing flexibility for certain services and preserving the low-end adjustment mechanism for a completely different set of services that remain subject to price-cap regulation. The *Fifth Report and Order* is, therefore, inconsistent not only with long-standing Commission precedent but also with the established principle that the government may not grant a benefit on the condition that a party give up a constitutional right that has little relationship to the benefit.

1. AT&T is flatly mistaken when it argues that, under *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989), the FCC is free to reduce Bell Atlantic's "price-capped" earnings to confiscatory levels so long as revenues from other parts of Bell Atlantic businesses keep it out of bankruptcy. AT&T Opp. at 3. Under *Duquesne*, the regulatory scheme embodied in a rate order is a closed system: *within that scheme*, rates must provide the utility an adequate return.

For that reason, it has long been clear that a company partly subject to regulation and partly operating in competitive markets may not be required to operate regulated segments of its business at a loss on the theory that profits from competitive lines of business will make up the shortfall. As Justice Holmes explained in *Brooks-Scanlon Co. v. Railroad Commission*, 251 U.S. 396 (1920), the profits that an enterprise earns in competitive operations are private property, and the firm "no more can be compelled to spend that than it can be compelled to spend any other money to maintain [the enterprise] for the benefit of others who do not care to pay for it." *Id.* at 399.[2] Indeed, that would be impossible: "Where competition prevails, a firm cannot compensate itself for losses on one venture by raising prices on other lines of business; if it tried to do so, competitors could profitably capture the business." *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 1034 (D.C. Cir. 1987).

The Commission has already defended the low-end adjustment as necessary "to ensure that the lower earnings do not constitute an unconstitutional taking."[3] Because eliminating the low-end adjustment risks depriving Bell Atlantic of a reasonable return on the services subject to price caps, it is irrelevant under *Duquesne* and *Brooks-Scanlon* whether Bell Atlantic could theoretically earn back its losses in competitive markets. The Commission does not need to wait, as ALTS suggests (Opp. at 4), to see whether Bell Atlantic is first driven to financial ruin.

---

[2] *See also Chicago & N.W. Transp. Co. v. United States*, 678 F.2d 665, 668 (7th Cir. 1982) (Posner, J.) ("The government may not force a railroad to operate a line at a loss . . . ."); *El Paso Elec. Co. v. FERC*, 667 F.2d 462, 468 (5th Cir. 1982) ("[W]ith respect to ratemaking, each jurisdiction or class of customers should pay its own way.").

[3] Brief for Respondents at 54 n.29, *United States Tel. Ass'n v. FCC*, No. 97-1469 (and consolidated cases) (D.C. Cir. June 15, 1998).

The "total result" test is a *prospective* test, applied in advance, not after a carrier is bankrupt. *See Duquesne*, 488 U.S. at 311-12.

2. Several commenters note that the low-end adjustment has been used only rarely (MCI Opp. at 4 & n.7) and that "the financial records of the price cap ILECs since the adoption of the price cap scheme indicate no need to worry about confiscatory rates." ALTS Opp. at 3 n.4. But these commenters entirely ignore the fact that interstate revenues are subject now to significant downward pressures. As Bell Atlantic explained in its petition, the Commission is currently considering various ways to lower these revenues in the future, *see* Pet. 10 & n.30, thereby exposing price-cap incumbent LECs to significantly greater risks than they have experienced under price caps so far. In its comments supporting the petition, U S WEST emphasized that the elimination of the low-end adjustment is "not a mere theoretical concern," for the Commission's current proposals — including raising the X-Factor and allowing special access and switched access to be provisioned entirely through the use of unbundled network elements — "have the potential of dramatically reducing price cap LECs' interstate revenues and triggering low-end adjustments as early as the next annual price cap filing." U S WEST Comments at 4; *see also* SBC Comments at 1-2 (supporting reconsideration in light of the "great deal of market uncertainty" caused by the Commission's UNE Remand Order).

3. MCI defends the elimination of the low-end adjustment mechanism by suggesting that the resulting plan is no different from the price-cap regime under which AT&T had to operate prior to being deemed non-dominant. *See* MCI Opp. at 5. According to MCI, because "[t]he AT&T price cap plan did not incorporate a low-end adjustment mechanism," the

elimination of the low-end adjustment for price-cap LECs "raises no constitutional concerns." *Id.*

MCI is wrong. The Commission originally established a low-end adjustment mechanism "to ensure that the plan automatically corrects itself should [the Commission's] selection of a productivity factor for the industry turn out to be too high *for a given company*."[4] The Commission has always recognized that particular LECs would experience differences in interstate earnings "caused by factors over which the LECs have no control, such as the strength of the regional or local economies in the areas in which a LEC provides service."[5] By imposing a single, industry-wide X-Factor on vastly different companies, the Commission acknowledged that,"[i]f a particular LEC is unable to meet the [industry-wide] X-Factor target in a given year, the low-end adjustment mechanism prevents price-cap regulation from becoming confiscatory."[6] If each company had its own X-Factor — as was true for AT&T when it operated under a price-cap regime — there would be little need for a low-end adjustment mechanism, for specific consideration of an individual company's productivity would already have been factored into the price-cap scheme. Therefore, MCI's analogy to AT&T's experience is wholly inapposite.

---

[4] Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6788 [¶ 10] (1990) ("*LEC Price Cap Order*") (emphasis added).

[5] First Report and Order, *Price Cap Performance Review*, 10 FCC Red 8961, 9048 [¶ 193] (1995).

[6] Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, *Price Cap Performance Review of Local Exchange Carriers; Access Charge Reform*, 12 FCC Rcd 16,642 16,704 [¶ 157] (1997).

4. Finally, AT&T argues that a rate-of-return of 10.25% — which represents the trigger for the low-end adjustment mechanism — is "well in excess of [a LEC's] current cost-of-capital," so falling below this rate is still "well above any risk of confiscation or basis for constitutional concern." AT&T Opp. at 3 & n.1. But, as AT&T knows full well, the Commission has established a "zone of reasonableness" for the cost of capital between 10.85% and 11.4%.[7] AT&T may not like this figure,[8] but this is not the appropriate proceeding in which to challenge it. The 10.25% trigger for the low-end adjustment is, therefore, entirely consistent with the purpose of ensuring that LECs' earnings are not so low that they "threaten the LEC's ability to raise the capital necessary to provide modern, efficient services to customers."[9] If the Commission were to determine, in an appropriate proceeding and on the basis of a proper record, that the cost of capital should be adjusted either up or down, it might then have a lawful basis for making a corresponding adjustment to the rate at which the low-end adjustment mechanism is triggered. There is no such basis here.

---

[7] *See* Order, *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, 5 FCC Rcd 7507, 7529 [¶ 189] (1990).

[8] *See* AT&T Opp. at 3 n.1 (citing comments filed pursuant to the Notice of Proposed Rulemaking, *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166 (Oct. 5, 1998)). Bell Atlantic and others have argued in this same proceeding that the cost-of-capital is higher than the Commission's current "zone of reasonableness." *See, e.g.*, Response to Direct Case and Reply Comments of Bell Atlantic, *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, at 2 (Mar. 16, 1999) (arguing that the cost of capital for the incumbent local exchange carriers is significantly above the current 11.25% benchmark — more in the range between 12.7% and 14.15%).

[9] *LEC Price Cap Order*, 5 FCC Rcd at 6804 [¶ 147].

CONCLUSION

For the reasons stated above and in Bell Atlantic's Petition for Reconsideration, the Commission should reconsider its decision to eliminate the low-end adjustment mechanism as a condition for granting Phase I and Phase II pricing flexibility.

Respectfully submitted,

MICHAEL E. GLOVER
EDWARD SHAKIN
JOSEPH DIBELLA
1320 North Court House Road
8th Floor
Arlington, VA 22201
(703) 974-4864

MARK L. EVANS
GEOFFREY M. KLINEBERG
KELLOGG, HUBER, HANSEN,
TODD & EVANS, P.L.L.C.
1301 K Street, N.W.
Suite 1000 West
Washington, D.C. 20005
(202) 326-7900

Counsel for the Bell Atlantic telephone companies

December 15, 1999

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of December, 1999, I caused copies of the foregoing Bell Atlantic Reply in Support of Its Petition for Reconsideration to be served upon the following parties by first-class mail, postage prepaid.

Mark C. Rosenblum
AT&T Corp.
295 North Maple Avenue, Room 1135L2
Basking Ridge, NJ 07920
Counsel for AT&T Corp.

Jonathan Askin
Association for Local Telecommunications Services
888 17th Street, N.W.
Washington, D.C. 20006
Counsel for ALTS

Charles C. Hunter
Catherine M. Hannan
Hunter Communications Law Group
1620 I Street, N.W., Suite 701
Washington, D.C. 20006
Counsel for Telecommunications Resellers Association

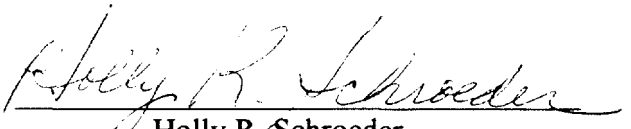
M. Robert Sutherland
Richard M. Sbaratta
BellSouth Corporation
1155 Peachtree Street, N.E., Suite 1700
Atlanta, GA 30309-3610
Counsel for BellSouth Corporation

Alan Buzacott
MCI WorldCom, Inc.
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
Counsel for MCI WorldCom, Inc.

Alfred J. Richter
Roger K. Toppins
Michael J. Zpevak
Thomas A. Pajda
SBC Communications Inc.
One Bell Plaza, Room 3003
Dallas, TX 75202
Counsel for SBC Communications Inc., Southwestern Bell Telephone Company, Ameritech, Pacific Bell, Nevada Bell, and Southern New England Telephone Company

Lawrence E. Sarjeant
Linda L. Kent
Keith Townsend
United States Telephone Association
1401 H Street, N.W., Suite 600
Washington, D.C. 20005
Counsel for USTA

Jeffrey A. Brueggeman
U S WEST Communications, Inc.
1020 19th Street, N.W., Suite 700
Washington, D.C. 20036
Counsel for U S WEST Communications



Holly R. Schroeder